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No. 77-870

In the Supreme Court of the United States

OCTOBER TERM, 1977

MISSOURI PACIFIC RAILROAD COMPANY, PETITIONER

v.

CITY OF PALESTINE, TEXAS, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE FEDERAL RESPONDENTS

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This case involves the validity of an order of the Interstate Commerçe Commission. The order, issued under Section 5 of the Interstate Commerce Act, 24 Stat. 380, as amended, 49 U.S.C. 5, approved a rail merger proposal and nullified certain state laws and contractual restraints that would have unduly burdened the unified rail operation.

1. In 1974 petitioner and its principal subsidiaries—Texas and Pacific Railway Co. (T&P) and Chicago & Eastern Illinois Railroad Co. (C&EI)—filed a joint application under Section 5(2) of the Act to merge the properties and franchises of T&P and C&EI into petitioner. Petitioner, T&P, and C&EI already operated a united system; the proposed merger was "merely a

'corporate simplification' designed to bring two near-wholly owned subsidiaries under the banner of the parent company" (Pet. App. 13).

In connection with their application, the railroads asked that petitioner be relieved of its obligations under the "Palestine Agreement." Its early history is recounted in *International & Great Northern Ry.* v. *Anderson County*, 246 U.S. 424. The International and Great Northern Ry. was required, under a contract reinforced by a state law, to keep its headquarters in Palestine, Texas (Pet. App. 34-39). After petitioner acquired the Great Northern, petitioner became insolvent. Petitioner explored the possibility of rearranging its corporate structure as part of its reorganization effort, so that it would emerge from reorganization as a unified company. The reorganization court, however, was powerless to nullify Great Northern's obligation, by then embodied in a judicial decree, to maintain its corporate headquarters in Palestine (Pet. App. 8-9). The courts suggested that petitioner seek a modification of the judicial decree.

In 1954 petitioner entered into negotiations with the City of Palestine to obtain a modification of the decree. The parties later executed the Palestine Agreement. The Agreement ended the Great Northern's obligation to maintain its general headquarters in Palestine; petitioner agreed, in exchange, to maintain 4.5 percent of its employees in certain job classifications in Palestine (Pet. App. 9, 40-41). The judicial decree was modified in accordance with the agreement, and petitioner and Great Northern were consolidated.

The present case arises out of petitioner's effort to eliminate its obligations under the Palestine Agreement. The City of Palestine and Anderson County objected to petitioner's request that the Commission abrogate the Palestine Agreement under Sections 5(2) and 5(11) (now

5(12)) of the Act as part of the Commission's approval of the merger of T&P and C&EI into petitioner.[1]

The Commission found that the Palestine Agreement imposes "undue burdens and obligations on [petitioner] and * * * will impose unduly burdensome, inefficient, [in]juriously wasteful, and unnecessary obligations on the proposed unified operations and upon interstate commerce" (Pet. App. 31). It concluded that "the Commission has the authority under section 5(11) of the act to relieve [petitioner] of these requirements, and that [petitioner] should be relieved of its obligations thereunder" (*ibid.*).

The court of appeals affirmed the Commission's order except insofar as the order relieved petitioner of its obligations under the Palestine Agreement (559 F. 2d 408; Pet. App. 4-24). The court agreed with the Commission that the Palestine Agreement would unduly burden petitioner's unified system and interstate commerce (Pet. App. 14-15). It held, however, that this is not sufficient to trigger the Commission's power under Section 5(2) and (11) to set aside petitioner's obligations (*id.* at 12):

> [W]e conclude that the ICC's power only extends to setting aside state restraints to the effectuation of an approved section 5(2) transaction and no further. Although the Palestine Agreement may burden [petitioner], the agreement clearly is not an obstacle

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[1] Section 5(2) provides that it shall be lawful, with the Commission's approval, "for two or more carriers to consolidate or merge their properties or franchises * * * into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership * * *." Section 5(12) provides that carriers participating in a transaction approved under Section 5 "are relieved from the operation of * * * all other restraints, limitations, and prohibitions of law, Federal, State, or municipal, insofar as may be necessary to enable them to carry into effect the transaction so approved * * *."

> to the merger of T&P and C&EI and does not threaten the merger's success. The ICC exceeds the scope of its authority when it voids contracts that are not germane to the success of the approved section 5(2) transaction.

Although the Commission had found the annulment of the Palestine Agreement to be related to the central objectives of the proposed merger—*i.e.*, to streamline rail operations and to enhance operational flexibility—the court disagreed. It stated (*id.* at 13): "Despite the irrelevance of the Palestine Agreement to the merger, the ICC has gratuitously relieved [petitioner] of its contractual obligations."

2. Petitioner asserts (Pet. 13) that, under the court of appeals' holding, "the Commission is limited by §5(11) and may nullify state law restraints only where the restraints would stand in the way of or absolutely prohibit a proposed consolidation." If that is the correct characterization of the court's holding, then it would be contrary to *Texas* v. *United States*, 292 U.S. 522; *Seaboard Air Line R.R.* v. *Daniel*, 333 U.S. 118; and *Schwabacher* v. *United States*, 334 U.S. 182, and would significantly frustrate the congressional policy of encouraging rail consolidations in the public interest.[3] But we do not read the court's decision so broadly. Although

[3] Cf. *First Lincolnwood Corp.* v. *Board of Governors*, 560 F. 2d 258 (C.A. 7) (*en banc*), which held that the Federal Reserve System may not disapprove the formation of a new bank holding company, even if its financial structure would be unsound, unless the reorganization would make financial conditions deteriorate. This Court has granted the Board's petition for certiorari (No. 77-832, granted February 21, 1978), which argued that the Board need not find that a particular condition will be aggravated by the change of corporate structure before it may order that condition corrected.

the opinion includes language that may lend support to petitioner's reading of the decision, the language is dicta at best. We believe that the decision stands only for the principle that the Commission may not nullify state law restraints that are not materially related to a proposed merger or consolidation within the Commission's jurisdiction. The court set aside the Commission's decision here only because it thought that the Palestine Agreement is irrelevant to the merger (Pet. App. 13).

We agree with petitioner that the court of appeals erred in finding, contrary to the Commission's determination, that the Palestine Agreement is unrelated to petitioner's corporate simplification merger. The Commission found that the Palestine Agreement's requirements will preclude petitioner from taking full advantage of the opportunities for savings made possible by the merger, and the Agreement thus frustrates the transaction that the Commission properly approved. The court of appeals should not have substituted its own judgment on this question for that of the Commission. See, *e.g.*, *Ralston Purina Co.* v. *Louisville & Nashville R.R.*, 426 U.S. 476. But because, in our view, the court of appeals' decision rests more on factual disagreement with the Commission than on any legal disagreement, the United States and the Commission did not file a petition for a writ of certiorari. Moreover, in the Commission's view, circumstances like those presented by this case are not likely to recur, because the Commission rarely exercises its nullification authority under Section 5(11) to upset agreements similar to this one.

Because the court of appeals erroneously set aside the Commission's factual determination, however, we will support the Commission's order if the petition is granted.

Respectfully submitted.

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